



Payden & Rygel

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Payden Ideas

Labor Day Observations – TIPS and EMD

September 2020



TIPS: Liquidity Dynamics

Consistent TIPS issuance has created a robust universe of bonds, but the TIPS market has fewer participants and is not as deep or liquid as the market for nominal Treasuries.

The behavior of real yields in March was an important reminder that technical dislocations can be extreme.

Real Yields spiked during the liquidity crisis in March

- Opportunities often arise from significant flows or periods of panic, which frequently feed on themselves and self-perpetuate
- Recognizing these additional risks of the TIPS market is essential when investing in this sector
- TIPS volume is ~\$20B per day, roughly equal to ~1% of total treasury issuance



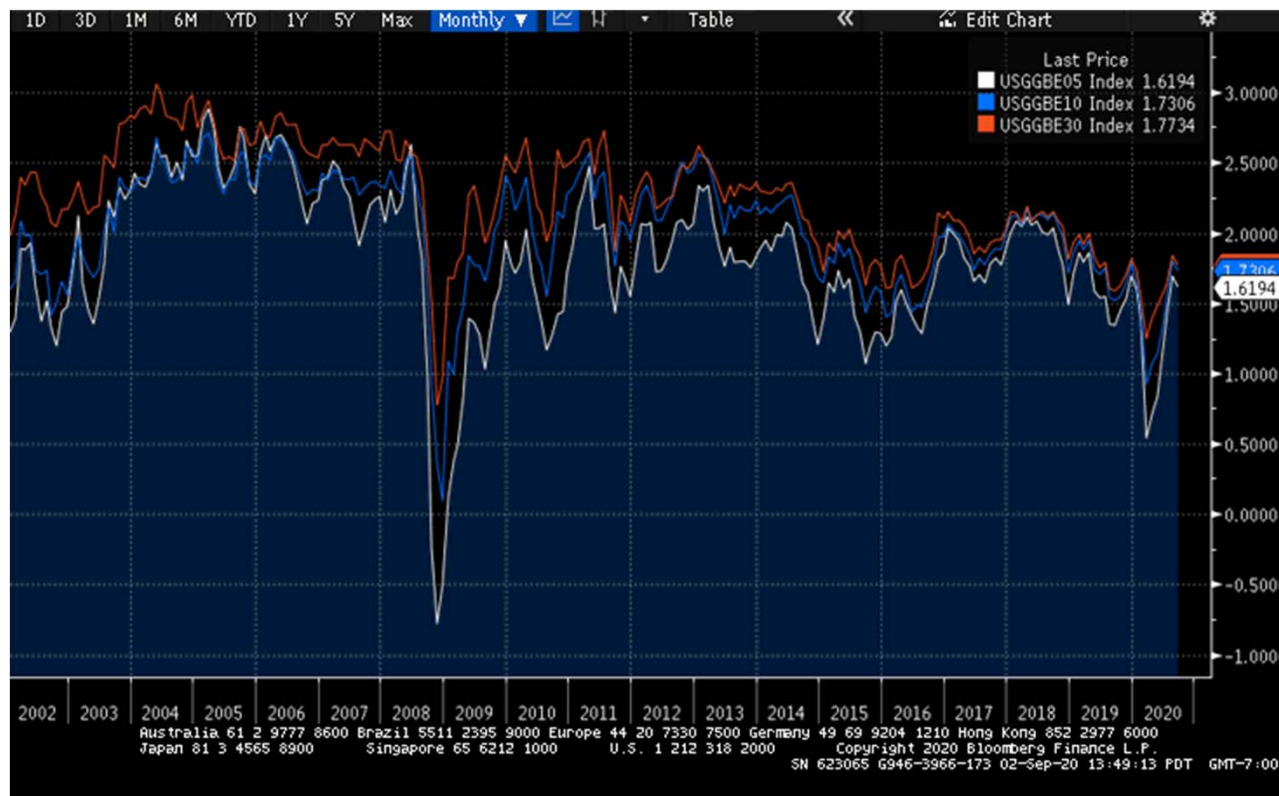


TIPS: Our Current View

- Positive view as an asset class, particularly as an alternative to nominal UST.
- Potential to outperform even with very modest price increases in the coming years.

Negative yields may not scream “value,” but several factors make the argument for an allocation to TIPS compelling.

Historical US Breakevens

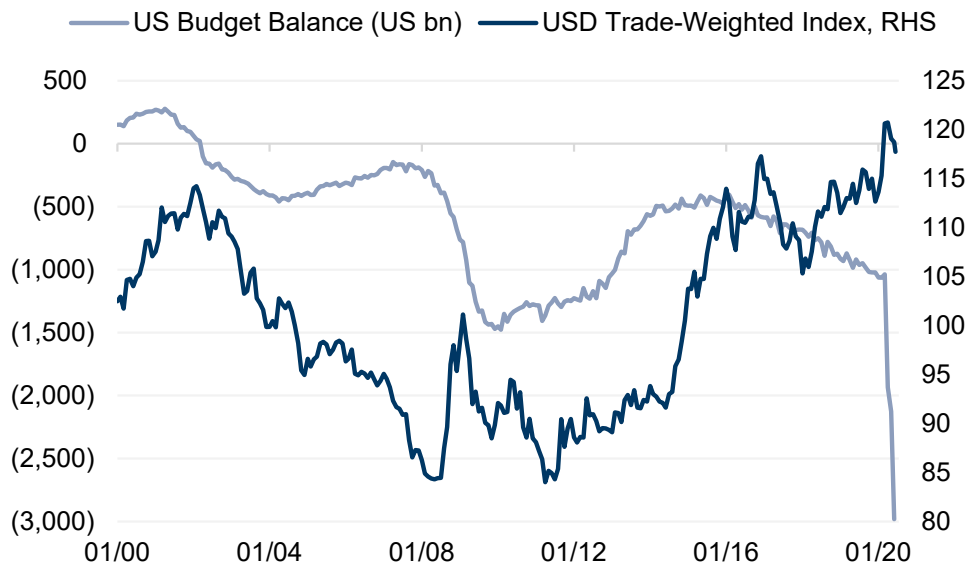


- The Federal Reserve is committed to maintaining a low level of interest rates and the entire breakeven curve is below their inflation target
- Risks remain: Covid-19's ultimate impact on prices is unknown, and easy monetary policy has not always translated into increasing inflation

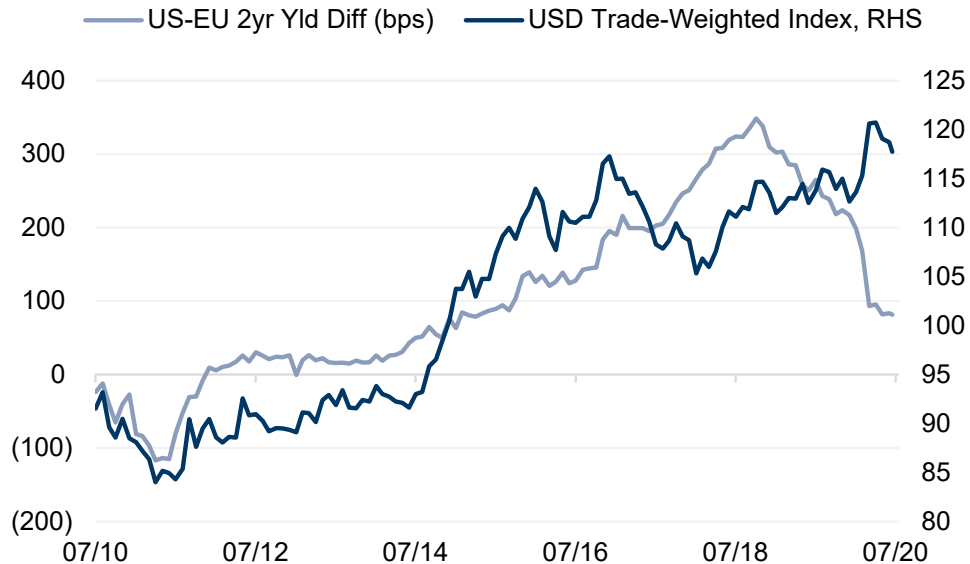


EM FX: Despite Weak Growth Backdrop, Reasons for Optimism

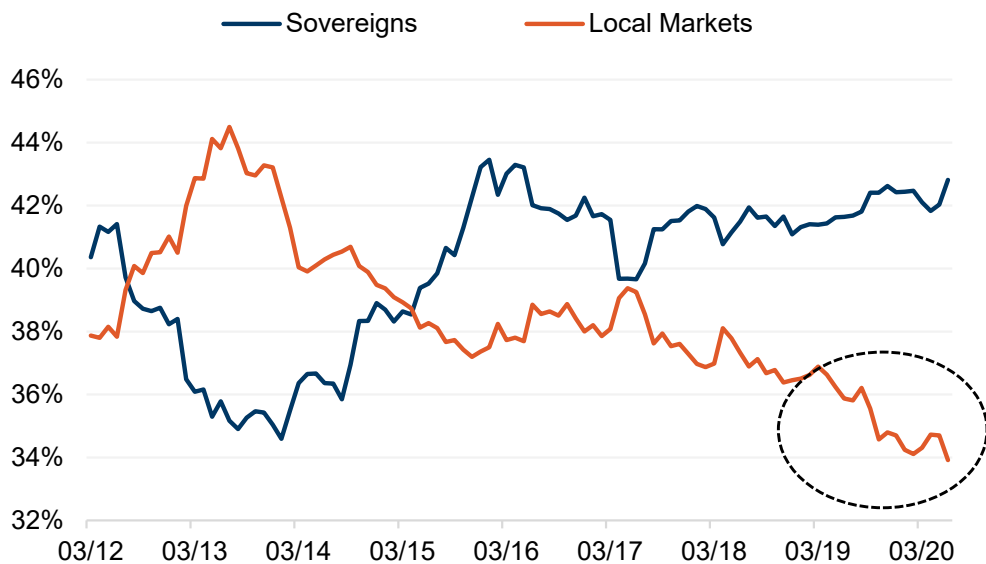
Fiscal deterioration to weigh on USD



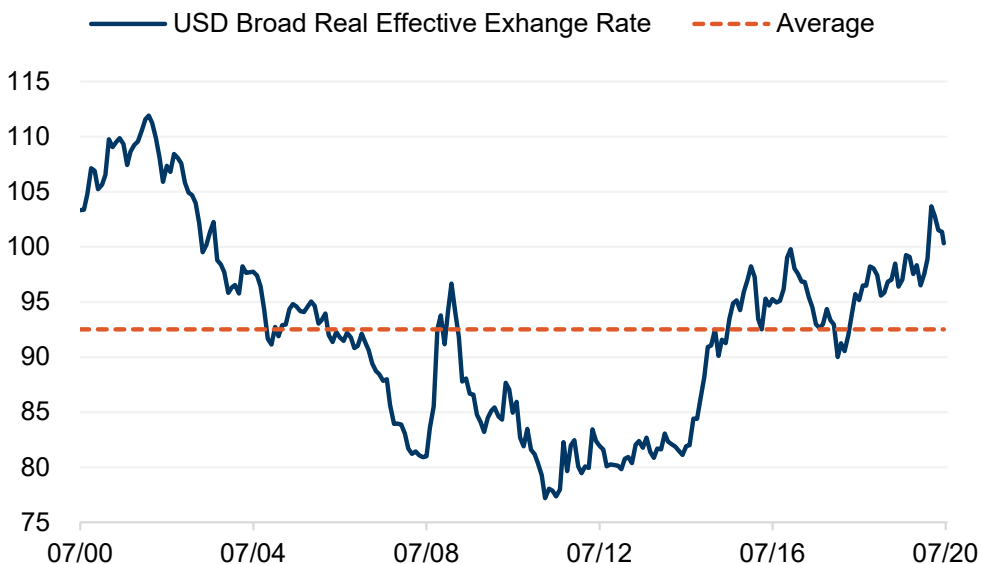
Interest rate differential has collapsed over the past year



EMFX allocation has declined, supporting technicals



USD overvalued based on long-term average REER

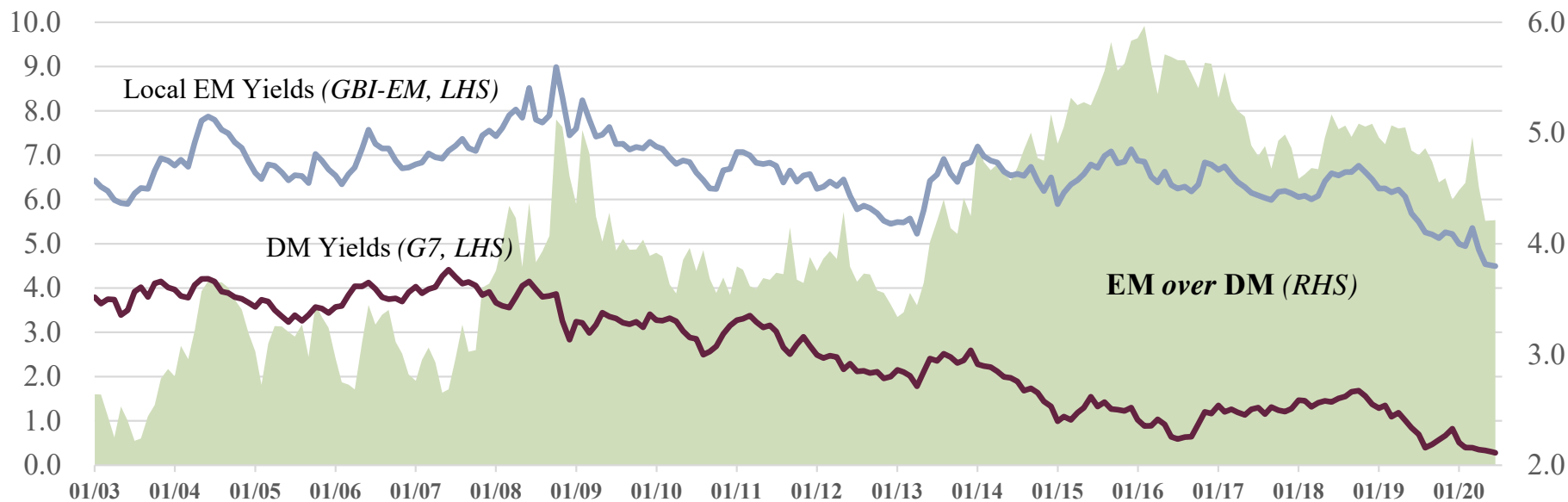


Source: Bloomberg, JP Morgan

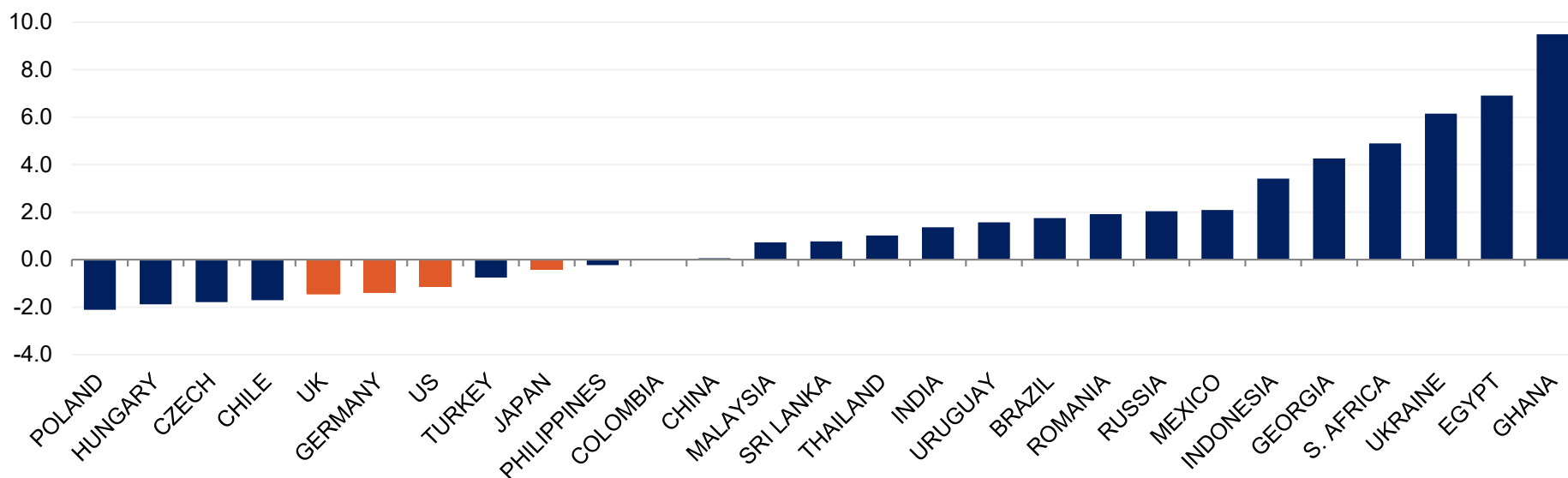


EM Rates: Compelling Yields versus Developed Markets

EM rates offer attractive pick-up to G7 (%)



Real yields* negative in DMs and euro area, positive in most EMs



Source: Bloomberg, JP Morgan, IMF

*5-year nominal local yield in each market, less 2020-2021 average expected inflation.